SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Knight | Analyst: Kimberly Pantoja | Bill Number: SB 109

Related Bills: None | Telephone: 845-4786 | Amended Date: 03/17/99

Attorney: Doug Bramhall | Sponsor:

SUBJECT: First-Time Homebuyer Mortgage Insurance Deduction

___ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ______.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

X AMENDMENTS RESOLVED THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced December 15, 1998.

X FURTHER AMENDMENTS NECESSARY.

X DEPARTMENT POSITION CHANGED TO Neutral.

___ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED December 15, 1998 STILL APPLIES.

X OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL), this bill would allow a first-time home buyer, as defined, to deduct the amount paid or incurred for mortgage insurance for the first five years the home is owned by the first-time home buyer.

SUMMARY OF AMENDMENT

The March 17, 1999, amendments deleted the provision allowing a private mortgage insurance deduction annually until 20% of the mortgage has been paid and inserted the language discussed in this analysis.

The amendments resolved some of the department's implementation considerations. Except for the issues below, the remainder of the department's analysis of the bill as introduced December 15, 1998, still applies. The following implementation considerations still apply and are included below for convenience.

SPECIFIC FINDINGS

This bill would allow a first-time homebuyer, as defined, to deduct the amount paid or incurred for mortgage insurance for the first five years the home is owned by the first-time homebuyer.

The deduction would be allowed regardless of whether the full insurance amount was paid at the time of purchase or is paid over the term of the loan. Typically, taxpayers with Federal Housing Authority (FHA) or Veterans Administration (VA) loans would pay the full amount at the time of purchase, therefore receiving a larger initial deduction than a taxpayer with a conventional loan.

Board Position:			Department/Legislative Director	Date
___ S	___ NA	___ NP		
___ SA	___ O	___ NAR		
X N	___ OUA	___ PENDING	**Johnnie Lou Rosas**	**3/26/1999**

By reference to the Health and Safety Code, this bill would define “first-time homebuyer” as a person who is a purchaser of an owner-occupied housing unit and who neither has, nor has had, a present ownership interest in a principal residence at any time during the three-year period prior to the date on which the mortgage is executed.

“Mortgage insurance” means insurance, including any mortgage guaranty insurance, against the nonpayment of, or default on, an individual residential mortgage, whether the insurance premium is paid periodically or as a lump sum. Mortgage insurance includes private mortgage insurance and mortgage insurance made available under the National Housing Act, Title 38 of the United States Code, or Title V of the Housing Act of 1949.

“Qualified single-family dwelling” means a residence consisting of one family dwelling unit located in this state that was purchased or constructed by a first-time homebuyer for an amount that is less than 140% of the median sale price for single-family dwellings sold during the calendar year immediately preceding the year of purchase or construction of the dwelling in the county in which the dwelling is located, as reported for the county by the California Association of Realtors.

“Residential mortgage” means a mortgage, loan, or other evidence of a security interest created with respect to a qualified single-family dwelling to finance the initial acquisition or construction of that dwelling.

The deduction allowed by this bill would be included with other miscellaneous itemized deductions and would be deductible only to the extent that the combined total exceeds 2% of the taxpayer's adjusted gross income (AGI).

Implementation Considerations

This deduction may be complex for taxpayers to calculate since it would be included as part of the taxpayer’s miscellaneous itemized deductions and limited to the extent that the total exceeds 2% of AGI.

The bill uses the term “first-time homebuyer” as defined in the Health and Safety Code. The Internal Revenue Code (IRC) and PITL define the term “first-time home buyer” as an individual (and if married, the individual's spouse) who had no present ownership interest in a principal residence during the **two-year** period ending on the date of acquisition of the principal residence. To the extent taxpayers and tax practitioners use the definition of "first-time homebuyer" in the PITL, the deduction would be disallowed. This one-year difference could cause disputes between taxpayers and the department.

Technical Considerations

On page 2, line 4, the normal structure in referring to taxable years is "beginning on **or** after," rather than "beginning on **and** after" as the bill is currently drafted. One could argue that technically a taxable year would only qualify if it began **both** "on **and** after" January 1, 1999. To correct this, amendment 1 has been provided.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses under the PITL.

Estimated Revenue Impact of SB 109 As Amended 3/17/99 [$ In Millions]		
1999-00	2000-01	2001-02
($5)	($5)	($5)

The bill would be effective for taxable years beginning on or after January 1, 1999.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The March 17, 1999, amendments increased the revenue estimate by $4 million annually from the estimate in the analysis of the bill as introduced. As amended, the total impact of the bill is losses on the order of $5 million annually.

The change that impacted revenue increased the types of eligible mortgage insurance to include that required for FHA and VA-guaranteed home loans. The other changes were consistent with assumptions made for the prior revenue estimate.

The amount of mortgage insurance premiums that exceed the 2% of adjusted gross income threshold and marginal tax rates of taxpayers with deductible premiums would determine the revenue impact of this bill.

Estimates are based on projected premiums paid by first-time homebuyers in California relative to new and existing loans (as applicable) for conventional, FHA, and VA loans. For the 1999 taxable year, projected premiums total on the order of $800 million. As a miscellaneous itemized deduction, mortgage insurance premiums would be included with other miscellaneous itemized deductions, if any, and would be deductible only to the extent they exceed 2% of adjusted gross income. By using personal income tax sample data and a series of reasonable assumptions as a proxy, deductible premiums are estimated to be on the order of $80 million annually. Applying an average marginal tax rate of 6% derives the estimates.

Mortgage insurance premium (MIP) estimates are based on the projected number of new FHA loans to first-time homebuyers in California in 1999: 201,000. The average loan is $115,000. FHA requires an up-front premium of a specified rate of the loan and is paid at closing or financed into the mortgage amount. Estimates assume that the up-front premium is considered paid at closing. Approximately two-thirds of borrowers pay an up-front premium equal to 2.5% of the mortgage amount, and one-third pays 1.75%. In addition, a monthly premium equals 0.5% of the mortgage amount. For new loans, six months of monthly premiums were included to reflect a mid-year purchase date.

The monthly premium also was used as a proxy to estimate the annual premiums paid by qualifying first-time homeowners with existing FHA loans. Estimated premiums for new and existing loans totaled on the order of $525 million.

Funding fee estimates are based on fees paid by veterans who are first-time homebuyers in California. For VA-guaranteed home loans, a funding fee is the equivalent of a mortgage insurance premium. The funding fee is based on the amount of the mortgage and will vary according to loan-to-value ratio. The fee may be paid in cash or included in the loan amount. Estimates assume that the funding fee is considered paid at closing. According to the Veterans Administration, funding fees attributed to first-time homebuyers in California are on the order of $40 million.

Private mortgage insurance (PMI) estimates are based on the approximate number of policies insuring conventional loans for first-time homebuyers nationwide: 2.5 million. It is assumed that California's distributive share of PMI policies is roughly equal to the number of owner occupied homes in California versus the nation, approximately 10%, or 250,000 policies. PMI premiums can be paid on either a monthly, annual, or single premium plan. According to industry contacts, 95% of policy premiums are paid monthly. Premiums are based on the amount and terms of the mortgage and will vary according to loan-to-value ratio, type of loan, and amount of coverage required by a lender. An average monthly PMI premium of $75 was used for the estimate. The average PMI policy is in force for less than five years. PMI premiums are estimated at $225 million.

BOARD POSITION

Neutral.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill, as introduced December 15, 1998.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENT TO SB 109
As Amended March 17, 1999

AMENDMENT 1

On page 2, line 4, strike "and" and insert:

or